

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
HOUGHTON MIFFLIN COMPANY }

Appearances:

For Appellant: Francis P. Farquhar, Certified Public
Accountant

For Respondent: W. M. Walsh, Assistant Franchise Tax
Commissioner; James J. Arditto, Franchise
Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Houghton Mifflin Corp any to a proposed assessment of additional tax in the amount of \$130.15 for the taxable year ended December 31, 1938.

The Appellant, a Massachusetts corporation, is engaged primarily in the business of publishing and selling books. Its publishing establishment and principal office are in Massachusetts, branch offices being maintained in California and other states from which the sales of tangible literary materials are made. Its activities also include the sale through its principal office of certain intangible literary properties. During the income year ended December 31, 1937, Appellant received income of \$66,744.91 from the sale of these intangibles which it lists and describes as follows:

"Half Profit Books	\$1,382.40
Royalties on Foreign Sales	4,417.42
Second Serial Books	4,666.55
Copyright Sales	3,744.86
Plate Rentals	51,533.68
Motion Pictures	1,000.00
	<u>\$66,744.91</u>

"An explanation of the above items may be given as follows:

"Half Profit Books: These are books which we agree to publish for an author, charging all expenses to the account, crediting all sales, and dividing the proceeds half and half. All of these contracts are made in Boston, and none of the authors live in California.

"Royalties on Foreign Sales: These are royalties on con-

Appeal of Houghton Mifflin Company

"tracts made in Boston with publishers in foreign countries for the sale of our books. The books may be shipped in printed or even bound form, but more usually the foreign publisher either buys the electrotypes from us, or sets them up in his own country.

"Second Serial Sales: These are sales of literary property made in Boston for publication in magazines, newspaper syndicates, etc. None of these sales were to citizens of California.

"Copyright Sales: These are sales of permission to use literary material in anthologies and other similar publications, made by our editorial department in Boston.

"Plate Rentals: These are royalties paid by various publishers to reprint books, and all of those sales were made to Grosset and Dunlap, Crowell Publishing Company, the Garden City Publishing Company, the Book-of-the-Month Club, Random House, Blue Ribbon Books, and P. F. Collier & Sons, all to the New York offices of those organizations.

"Motion Pictures: This was our commission on the sale of one of our books to Warner Brothers, Inc. The contract was dated and executed in New York State."

It is the position of the Commissioner that the business of the Appellant is unitary in nature and that the entire net income of the Appellant, including the income from sales of the intangibles, is subject to allocation pursuant to Section 10 of the Act. Appellant contends that the intangibles have not acquired a taxable situs within California and no portion of the income from such intangibles should be allocated to this State. Appellant also contends that the sale of the intangibles is incidental to its business of publishing and selling books and is not a part of the unitary business.

The arguments of Appellant have no application, in our opinion, to the present situation wherein the acquisition, management and disposition of the intangibles constitute integral parts of the corporation's regular business operations. The Appellant must acquire literary material by purchase and employ a staff of experts for that purpose. Having purchased this material, expenditures are made for advertising, promotion and the sale of its properties. No accurate segregation of these expenses between its tangible and intangible literary properties has been made by Appellant.

It is also to be observed, as further evidence of the unitary character of Appellant's business, that the intangibles would have little or no value but for the Appellant's publishing activities and its sales of tangible literary property in California and other states. A public demand thus has been created which establishes a market and makes possible the realization of income from the sale of the rights to use the literary material. It would seem clear that a portion of such intangible income is, in fact "derived from business done within this State" and subject

Appeal of Houghton Mifflin Company

to allocation.

Appellant further insists that it sells more "educational" books than "trade" books in California and that its sales of "educational" books contribute nothing to income from the sale of literary rights. It has not submitted evidence, however, establishing such a departmentalization of its business or the independence of its operations in various fields of publication as to permit a segregation of income for purposes of allocation,

Adding support to our views is the decision of the Supreme Court of California in Holly Sugar Co. v. Johnson, 18 Cal. 2d 218. In that case a foreign corporation, for the specific purpose of furthering its regular business operations, acquired a majority of the shares of a California company. The court held that the facts established an "integration of the activities of the two companies into one indivisible, composite whole, each portion giving value to every other portion," (at page 224) and the loss sustained by the foreign corporation on liquidation of the subsidiary was required to be included in the income base against which the allocation formula was applied, notwithstanding the fact that the loss resulted from ownership of intangibles. Adjudicated cases to the contrary appear to involve the attempted allocation of intangible income which did not arise from the conduct of a unitary business. Cf. Fargo v. Hart, 193 U. S. 490; People ex. rel. Alpha Portland Cement Co. v. Knapp, 230 N. Y. 48, 129 N. E. 202; California Packing Co. v. State Tax Commission, 97 Utah 367, 93 P. 2d 463.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDER, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Houghton Mifflin Company to a proposed assessment of additional tax in the amount of \$130.15 for the taxable year ended December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of March, 1946 by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary